Forecasting challenges and the UK economy

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* Partly draws on joint empirical work with my colleague Dr Mike Ellington (Liverpool)

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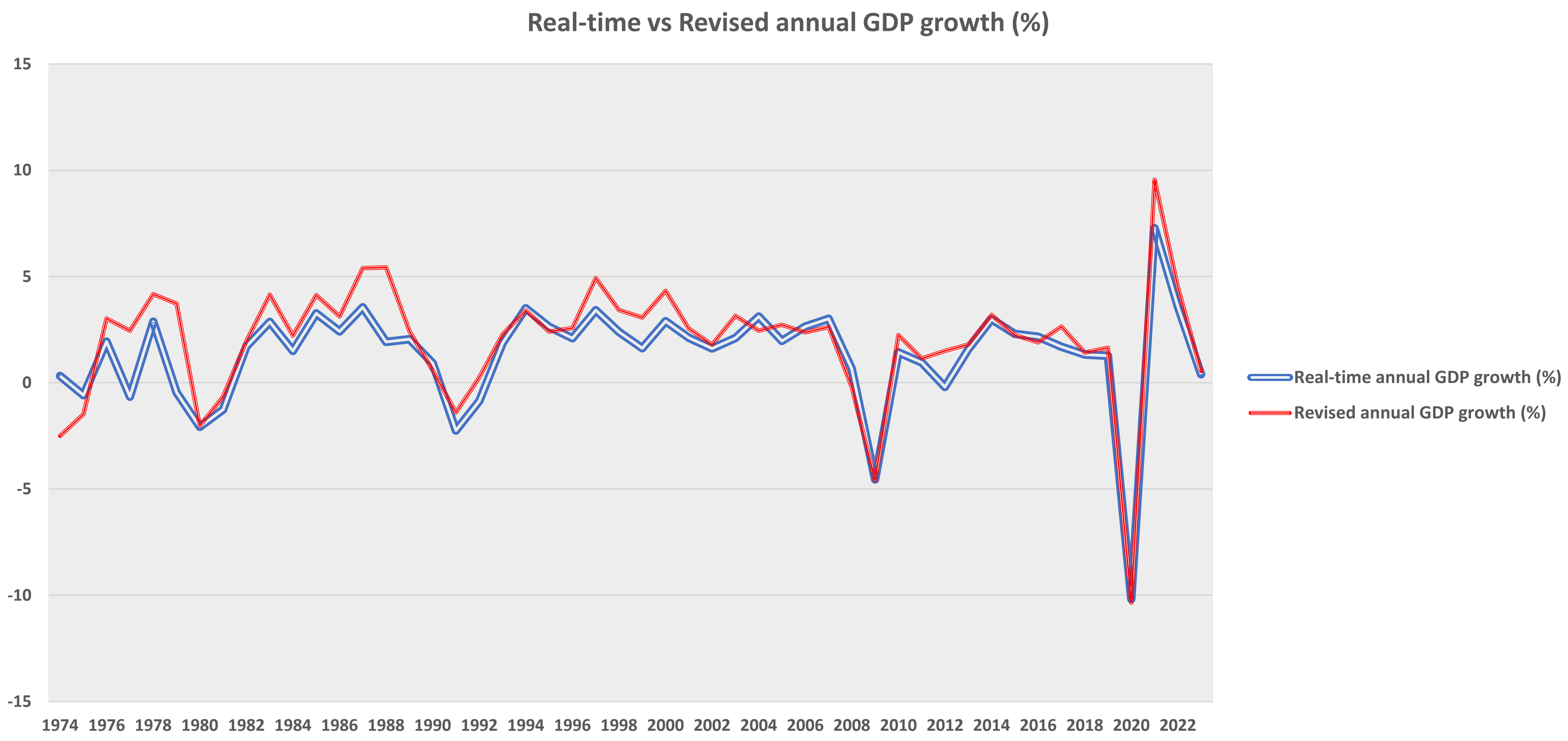
Greek scientist Thales of Miletus famously noted that “the past is certain, the future obscure”.

Dan Brown took the above argument further in his best-selling book “The Da Vince Code” by noting that “today is today. But there are many tomorrows”.

Titan of science Thales of Miletus and *Titan* of fiction Dan Brown are, to some extent, wrong! Statistical revisions to economic data can change dramatically what we believe about past and present! **Chart 1** elaborates…

Chart 1



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Real-time (or first) estimates by the Office for National Statistics (ONS) suggest average UK GDP growth of 1.3% per annum.

ONS then revises the past upwards! In fact, revised estimates by the ONS suggest average UK GDP growth of 2% per annum.

Forecasting the UK economy: My forecasts

	2023	2024		
	Q4	Q1	Q2	Q3
GDP Growth (Quarterly, % change)	-0.1	0.0	0.2	0.2
Inflation (CPI All Items, % change YoY)	4.5	4.1	3.5	3.0
Unemployment (% rate, all 16 and over)	4.3	4.5	4.6	4.6
Interest Rates (official Bank Rate)	5.3	5.0	4.8	4.5
Earnings Growth (Excl bonuses, % change YoY)	7.1	5.9	5.2	4.3
Lowest £/€ Exchange rate (lowest point between 31st Jan – 31st Oct)		1.08		

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Prediction ‘highlights’

GDP contracts in 2023Q4 and then slightly recovers from mid-2024 onwards. As GDP initially contracts/weakens, unemployment rises.

As inflation drops, wage growth slows down but exceeds inflation and therefore real wage growth (wage growth minus inflation) approaches 1%, that is, the long-run UK average **since…1209**!

Warning: robust real wage growth requires productivity gains (productivity is currently “hammered” by weak business investment).

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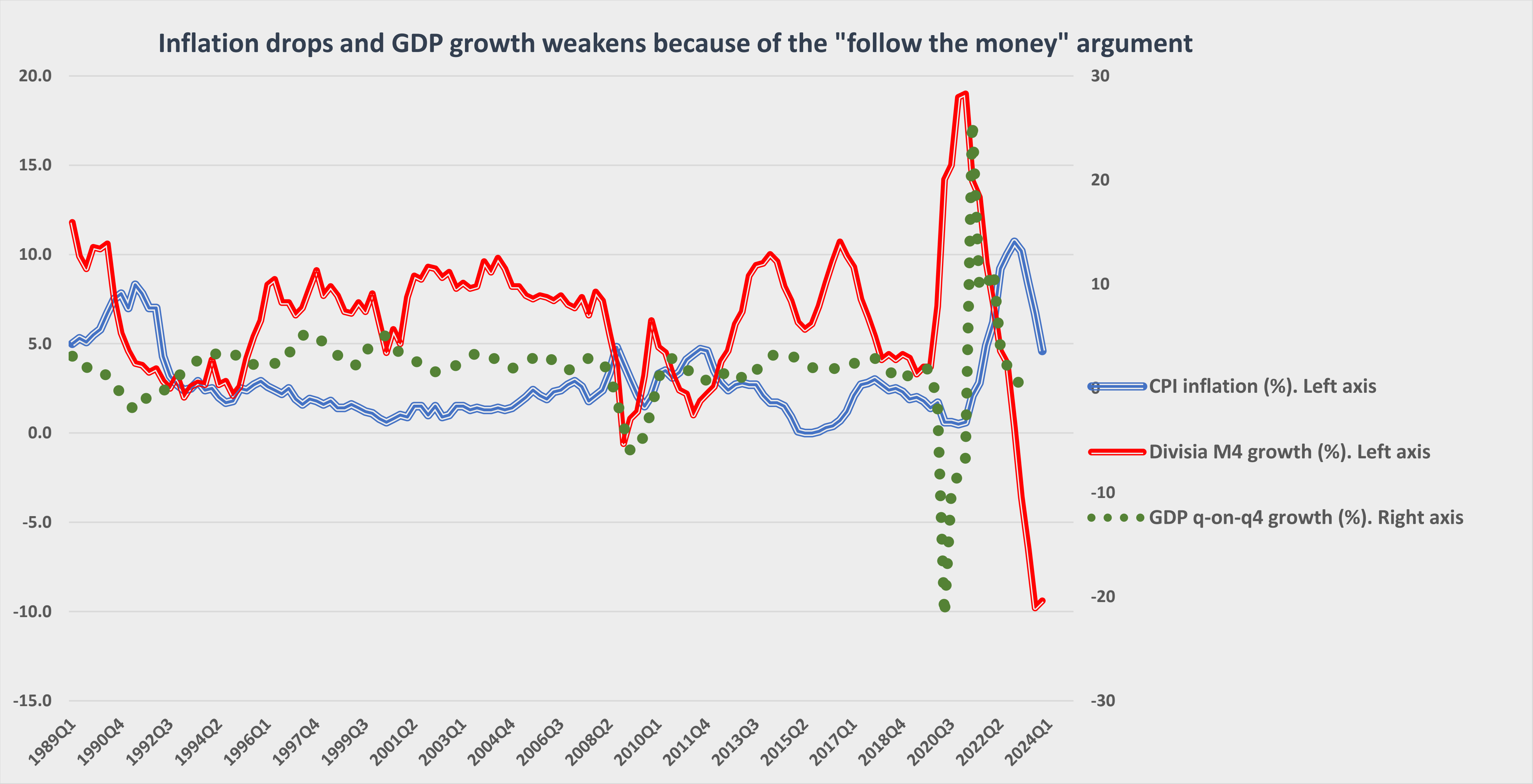
Prediction 'highlights'

Currently at 5.25%, the official Bank rate exceeds the long-run average (**since…1694**) of 4.7%. Bank rate is cut in 2024 which, somewhat, lifts GDP growth.

My predictions for GDP weakness until mid-2024 are largely based on the "follow the money" argument (see **Chart 2**).

Money measures liquidity. More money stimulates the economy but also leads to higher inflation.

Chart 2



Inflation drops and GDP growth weakens because of the "follow the money" argument
20.0
15.0
10.0
5.0
0.0
-5.0
-10.0
-15.0
30
20
10
-10
-20
-30
1989Q1
1990Q4
1992Q3
1994Q2
1996Q1
1997Q4
1999Q3
2001Q2
2003Q1
2004Q4
2006Q3
2008Q2
2010Q1
2011Q4
2013Q3
2015Q2
2017Q1
2018Q4
2020Q3
2022Q2
2024Q1
CPI inflation (%). Left axis
Divisia M4 growth (%). Left axis
GDP q-on-q4 growth (%). Right axis

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From mid-2024, however, GDP growth picks up due to a slight improvement in EU growth from 0.6% in 2023 to 1.3% in 2024). Notice that 42% of UK exports go to the EU.

The exchange rate is a measure of confidence in the UK economy. With UK growth remaining fairly weak and Eurozone growth slightly picking up, there is little exchange rate movement.

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A ‘Black Swan Event’ that might upset my predictions:

I will flag rising (economic) policy uncertainty related to the timing (and possibly the result) of the general election.

Economic policy uncertainty slows down [investment] and, consequently, [harms] the economy.

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Should *you* have faith in my forecasts or the forecasts of any other economic “expert”?

In November 2019, Chris Giles (Economics Editor of *The Financial Times*) wrote that economists perform much worse on similar trust surveys than scientists or medics, although they score better than journalists and politicians.

So, how can we, economists, defend and improve our forecasts?

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We should flag that our predictions are almost exclusively based on real-time data and therefore come with health warnings. Indeed, real-time data are heavily revised over time and, therefore, updated data might reject a forecast that was potentially supported by earlier data.

We should use different model specifications to provide alternative forecasts!

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In my case, I mainly relied on the "follow the money" argument and (weak) growth in the EU.

It is our job to inform the public that there are no "right answers" to every economic question, such as "what is the right/most reliable forecast for GDP?" Doing so would definitely please historians who consider anathema the misguided idea that there are "right answers" to every historical question.

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Can your forecasts turn out "better" than mine?

Absolutely! Some good news:

Since 2006, public forecasts of inflation (also here) two years down the road have over-estimated actual CPI inflation by an annual average of "only" 10 basis points whereas the Bank of England has under-estimated CPI inflation by an annual average of 68 basis points. In other words, we should pay attention to the wisdom of crowds!

Please have faith in your own forecasts and **good luck!!!**

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